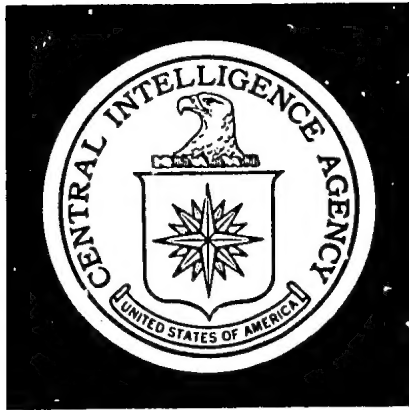


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2009/10/06 :
CIA-RDP85T00875R00160001

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Algeria: Prospects for Continued Accumulation of Reserves

Secret

ER IM 68-104
AUGUST 1968

COPY NO. 40

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
August 1968

INTELLIGENCE MEMORANDUM

Algeria: Prospects for Continued Accumulation
of Reserves

Summary

Algerian reserves may now be approaching \$450 million. Since 1965, official holdings of gold and foreign exchange have risen by more than \$100 million annually and at the end of 1967 totaled \$400 million. Until mid-1967, accumulation of reserves was largely inadvertent -- the result of rising petroleum revenues, meager investment expenditure, and falling demand for consumer imports. Reserve expansion since then has been accelerated by deliberate government restrictions on expenditures abroad.

The Boumediene government has budgeted funds to be used from 1968 through 1970 for greatly expanded government investment, mostly in heavy industry. Algeria cannot finance the foreign exchange requirements of such investment without using up its reserves. Previous government investment budgets, however, have rarely been more than 50 percent expended. The administrative disorganization that has always impeded implementation of government projects is not likely to vanish in the next few years. With oil exports growing rapidly, continued underexpenditure of investment budgets would permit the continued accumulation of reserves, although at a slower rate. Nationalization of French oil-producing companies could reduce export earnings and capital

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of National Estimates and the Office of Current Intelligence.

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inflow enough to create a payments deficit, but such an action by the present regime is improbable.

Benefits from the new government industrial projects will be small, since they are not labor intensive. Gross national product (GNP) will rise, but output will be high cost and the bulk of the Algerian population will remain poor and under-employed. The largest share of government investment is to be devoted to heavy industry, including steel, petrochemicals, and refineries, and thus employment opportunities will be expanded very little. Moreover, few existing state enterprises have shown a profit, and many are subsidized. There is a great shortage of skilled workers and managerial personnel, and many enterprises are operating well below capacity as a result. Unless efficiency improves, the proposed industrial complex will constitute a drain on the treasury for many years to come.

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Introduction

1. During 1967, Algeria emerged as a radical Arab state with cash to spare. Since the Arab-Israeli War of June 1967 the Boumediene government, for the first time, has been willing to provide financial support to radical Arab causes. The UAR, Jordan, Syria, and the Republic of Yemen have received small grants. Following the June war, Algeria's appeal for a concerted Arab effort to undermine the dollar was rejected by wealthier and more conservative Arab states. Nevertheless, in November and December 1967, in pursuance of its undermining policy, Algeria purchased \$150 million in gold from the US Treasury at a time when sterling and the dollar were under severe pressure.

2. The rapidity with which Algeria has accumulated surplus reserves is more significant than their size. At the end of 1967, reserves of \$400 million placed the country fourth among affluent Arab nations. It is dwarfed by Libya, Saudi Arabia, and Kuwait and may eventually be overshadowed by a federation of Persian Gulf sheikhdoms. As late as 1965, Algerian reserves were only \$174 million. Since that date, because of rising petroleum revenues and diminishing transfers and payments abroad, a growing surplus has developed in the balance of payments, and reserves have increased at a rate of more than \$100 million per year (see Table 1).

Balance-of-Payments Trends

3. From independence in 1962 until 1965, balance-of-payments deficits were chronic in Algeria. The departure of the French managerial class and the flight of capital were largely offset by large grant aid from France. As a consequence, official reserves were drawn down only moderately, from \$312 million at the end of 1961 to \$174 million in 1965. A negative trade balance was largely responsible for the balance-of-payments deficit. During this period, repatriation of profits by foreign oil companies in Algeria was compensated for by receipts from Algerian workers in France. In the first few months following independence, the outflow of capital accompanying the flight of French settlers probably was covered by Algerian

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Table 1

Algeria: Estimated Balance of Payments a/
1964-67

	Million US \$			
	1964	1965	1966	1967
Goods (balance)	-6	-38	78	141
Exports	742	698	753	806
Petroleum	394	376	473	547
Natural gas		32	32	36
Wine (f.o.b.)	147	125	98	73
Other	201	165	150	150
Imports	-748	-736	-675	-665
Capital goods	-154	-117	-122	-165
Oil companies	-54	-40	-22	-40
Algerian govern- ment	-100	-77	-100	-125
Consumer goods	-594	-619	-553	-500
Services and transfers	5	-44	-95	-140
Algerians working abroad	131	137	143	150
Algerian share of French technical assistance	-45	-50	-45	-45
Profit repatriation	-143	-148	-214	-233
Interest on public debt	-16	-18	-15	-20
Official grants	78	35	36	8
Capital	-15	79	128	138
Private long-term inflow	226	140	111	125
Private short-term inflow	9	8	7	8
Official long-term inflow	105	67	56	55
Public debt amortization	-88	-106	-46	-50
Private capital outflow	-267	-30	Negl.	Negl.
Errors and omissions	-142	-4	-10	-14
Balance <u>b/</u>	-158	-7	101	125

a. Data are derived [redacted] from the terms of international agreements in force through 1970; Algeria has never maintained an official balance-of-payments record. The format of estimates for 1964 provided by the IMF has been adjusted to accommodate data available from other sources and for later years.

b. Deficits are financed largely by reserve draw-down.

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government drawings from the French Treasury of more than \$500 million. From 1962 to 1964, capital outflow largely was offset by official French government aid of about \$800 million. As income fell and European consumers left, demand for imports fell. However, neither reduced imports nor increased petroleum output compensated for a steady decline in export of agricultural commodities that were produced on farms formerly owned by Europeans.

4. In 1965, Algeria's foreign payments were roughly in balance, compared with the deficit of more than \$150 million the previous year. The improvement was due to the cessation of capital flight as the departure of French settlers was completed. The gain from this source was more than \$200 million, exceeding the decline in French official aid and in the inflow of long-term private capital. In 1965 the growth of petroleum exports was halted temporarily because of bottlenecks in pipeline capacity.

5. From the near balance of 1965, foreign payments shifted to surpluses in excess of \$100 million in both 1966 and 1967. The opening in 1965 of a third pipeline from Haoud el Hamra to Arzew broke the transportation bottleneck for crude oil, and production has subsequently risen by at least 15 percent annually. Export earnings from petroleum grew from \$376 million in 1965 to \$547 million in 1967, much more than offsetting a continuing decline in traditional exports. Completion of a gas liquefaction plant at Arzew in 1964 has resulted in exports of liquid methane of more than \$30 million a year. Imports of consumer goods continued to decline, mainly because of falling per capita income. Imports of capital goods rose, but only slowly because of limited implementation of development projects.

Policies Under Boumediene

6. Much of Boumediene's success in amassing reserves has been the result of events outside his control. Even the sluggish performance of capital goods imports is a reflection of the lack of coherent government planning and of disorganized administration rather than of efforts to hold down foreign exchange expenditures. Nevertheless,

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especially in 1967, the accumulation of reserves owes something to deliberate government policies. Control over and strengthening of foreign payments have been key objectives of economic policy under this regime.

7. Boumediene has more control over the management of Algeria's international transactions than did his predecessor, Ben Bella. At one time the Banque de France recorded on the Algerian account only royalties and taxes paid by French oil companies, and the balance of total proceeds from petroleum was credited to the French balance of payments. Algeria now receives full credit, and the proceeds are fully convertible. Furthermore, a petroleum accord signed in 1965 prohibits French oil companies from spending or transferring abroad more than 50 percent of their gross proceeds from petroleum sales. Since France controls about 70 percent of Saharan petroleum production, Algeria has, in effect, been promised that 35 percent of its petroleum proceeds will be a net and fully convertible payments gain.

8. So far, Algeria has gained economic independence from France without sacrificing many old privileges of association. Since the 1965 petroleum accords, France has reduced its direct grant commitments to Algeria to only \$8 million annually, and the bulk of the French aid commitment consists of \$32 million annually in loans and \$40 million in government-guaranteed credits. Nonetheless, France remains a major source of aid. With the exception of wine, Algerian goods still enter France free of restrictions, and 1,000 Algerian workers may migrate to France each month. Remittances to Algeria from citizens resident in France also are unrestricted* and contribute at least \$150 million annually to Algeria's foreign exchange income. Distributors of petroleum products in France still are required by law to purchase a fixed percentage of crude oil from Algeria at premium prices. As a result, in 1966 more than

* *All transfers from France were restricted temporarily in May 1968, but long-term policy with respect to remittances of Algerian workers has not been altered by the 1968 payments crisis in France.*

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60 percent of the Algerian crude output was sold at highly advantageous prices in the French market. French investment in Algeria, which has been concentrated almost entirely in the petroleum industry since independence, also has been relatively unhampered. During the 1965 petroleum negotiations, it fell to \$89 million from \$181 million the year before, but by 1967 it had begun to rise again. The incentive of French firms to invest in nonpetroleum activities in Algeria probably was hampered by the nationalization of 25 French firms in 1968, but the direct impact of this action is slight. Since independence, disinvestment has been the pattern in these and other manufacturing concerns.

9. Under Boumediene, investment outside the petroleum sector has been directed largely toward import substitution or export stimulation. The textile industry has been expanded rapidly and protected heavily to reduce dependence on imports. The government also has been milking efficient industries to subsidize dubious export products. For example, the profitable Ouenza iron mines have become the nucleus of a national mining corporation that will rehabilitate numerous mines, formerly abandoned as uneconomic, to produce ores for export.

10. Transactions with many countries have become deliberately niggardly. In 1968 the USSR will buy one million hectoliters of Algerian wine unmarketable elsewhere. After 1968, 5 million hectoliters per year, most of Algerian production, will go to the USSR. Moreover, Algeria is insisting that the USSR maintain a trade deficit that will offset interest and amortization on the Algerian debt to the USSR, which is mostly for military goods. Other Eastern European trading partners also are being offered wine, despite their evident lack of interest, and are being denied citrus fruits, which the Algerians wish to market for hard currency. Since 1962, US surplus food worth about \$175 million has been donated to Algeria. Despite this, the refining and marketing operations of US oil companies were nationalized in 1967 and absorbed by the Algerian government company, SONATRACH.

11. Since June 1967 President Boumediene has intensified his efforts to widen the payments

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surplus. A new tariff schedule ranging from 20 percent to 100 percent ad valorem has replaced a quota system formerly used to provide preferences for French goods. As a result, imports of consumer goods have been cut, and commercial transactions with France have been reduced. Algerian relations with foreign companies operating in the country have been jeopardized in a major effort to reduce overseas expenditures and thus to retain foreign exchange earnings. US petroleum companies have been forbidden to pay for imports with funds earned in Algeria or to repatriate profits. In an address to Party workers and government employees on 5 January 1968, Boumediene pointed to Algerian reserve accumulation as a major economic achievement. Since then, strenuous controls designed to perpetuate the payments surplus have been maintained, even though reserves now equal about 60 percent of annual imports.

Short-Term Prospects

12. Even though Boumediene plans to accelerate the country's development effort, Algeria probably will continue to add to its foreign exchange reserves for several more years, if present policies continue (see Table 2). Investment plans, if largely fulfilled, would so increase capital goods imports that balance-of-payments deficits would result. Little reason exists, however, to expect more than a very partial fulfillment of these plans, and increased import requirements are likely to be more than covered by rising exports. Thus an apparent inconsistency between the government's development goals and its policy of further strengthening the balance of payments probably will not become a source of real policy conflict.

Foreign Exchange Earnings

13. The continued increase in foreign exchange reserves will stem largely from increased earnings in the petroleum and related industries. If petroleum production continues to increase at 15 percent per year, as seems likely, sales will total about \$800 million by 1970. If a second gas liquefaction plant is completed on schedule by 1970 and contracts that have been negotiated with the United Kingdom,

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Table 2

Algeria: Projected Balance of Payments
1968-70

	Million US \$		
	<u>1968</u>	<u>1969</u>	<u>1970</u>
Goods (balance)	126	166	271
Exports	846	946	1,131
Petroleum	600	700	800
Natural gas	36	36	121
Wine (f.o.b.)	60	60	60
Other	150	150	150
Imports	-720	-780	-860
Capital goods	-220	-280	-360
Oil companies	-40	-40	-40
Algerian govern- ment <u>a/</u>	-180	-240	-320
Consumer goods	-500	-500	-500
Services and transfers	-187	-235	-287
Algerians working abroad	150	151	152
Algerian share of French technical assistance	-45	-45	-45
Profit repatriation	-280	-326	-377
Interest on public debt	-20	-23	-25
Official grants	8	8	8
Capital	203	197	117
Private long-term inflow	125	128	125
Private short-term inflow	8	8	9
Official long-term inflow	127	129	67
Public debt amortization	-57	-68	-84
<i>Balance</i>	<i>142</i>	<i>128</i>	<i>101</i>

a. Assuming a 50-percent implementation of the investment program.

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France, and Spain for liquid methane are fulfilled, as now seems likely, gas sales should add another \$120 million annually to proceeds from petroleum. Algerian gas reserves are now the third largest in the world. Sales of wine and other traditional exports are expected to remain at near current levels (about \$223 million in 1967). Thus Algeria should acquire somewhat more than \$1 billion in export earnings in 1970. Because of Algerian restrictions, profit repatriation by oil companies should not exceed \$400 million in 1970. Remittances from abroad and current levels of foreign aid and investment amply exceed other Algerian expenditures abroad.

14. Failure to settle Algeria's current quarrels with France could cause some minor problems. Pressure from French wine growers may well persuade the French government to prohibit the sale of Algerian wine in the protected French market. By 1970, however, Algeria's vineyards probably will yield no more than 6 million hectoliters of wine, a quantity that would bring about \$60 million if sold in a free market. The same quantity sold in France would yield only \$12 million more. France might also curtail immigration of Algerian workers more drastically (a limit of 1,000 per month has been imposed temporarily), but the level of remittances by workers already in France is unlikely to drop for some time.

15. A serious commercial rupture with France is unlikely to occur so long as economic considerations dominate political animosities. The 1965 petroleum accords will govern most Franco-Algerian financial affairs through 1970, and no occasion for a major dispute will arise before 1969, when renegotiations begin. In 1966, more than half of all Algerian products, including petroleum, were sold in France. Similarly, Algeria still was France's eighth largest market and its single biggest source of fuels. Currently, Algeria is seeking new suppliers and new markets, and France is seeking to diversify its sources of natural gas and petroleum. Mutual reliance will diminish moderately, as the French market is incapable of absorbing large increases in Algerian petroleum output. Nonetheless, France should continue its primacy as a trading partner, and neither country

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could find a substitute for the other quickly. Nationalization of French petroleum-producing companies would alter Franco-Algerian relations radically, but this degree of irrationality is unlikely to be manifested while the current Algerian and French regimes are in power. Even Ben Bella admitted publicly that Algeria was totally incapable of operating its enormous -- and largely French-managed -- petroleum sector.

Imports and Economic Development

16. Boumediene has announced an investment program designed to enhance Algeria's image as an industrial power. Although no formal development plan exists, funds have been budgeted for a long list of projects which are to be implemented in the next few years. A steel mill, partially financed by French and Soviet credits, is under construction at Annaba. Ground has been broken for a fertilizer factory which is to be the first unit in a gigantic petrochemical complex. Materials have been ordered for a new petroleum pipeline and a natural gas pipeline. A second gas liquefaction plant is to be constructed at Skikda by 1970, and at least one other petroleum refinery and a third liquefaction plant have been proposed. Boumediene claims that 90 percent of the total cost of these projects will be financed by Algeria.

17. The development goals for heavy industry would require large imports of capital equipment and a steady inflow of skilled personnel. Except for fuels, mediocre iron ore, and relatively small amounts of phosphates, Algeria's resources are meager. Economic infrastructure is even more limited. Algeria has a very small construction industry which is not capable of building or equipping modern industrial plants. The steel complex being constructed at Annaba will not operate before 1970 or 1971. Human resources are poorest of all. Some Algerians are being trained abroad and in new technical institutes, but it will be many years before their numbers are great enough to staff the proposed industrial plants. The only successful state enterprise at present, SONATRACH, is heavily staffed by personnel from US consulting firms and by Soviet and Rumanian technicians.

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18. Few additional opportunities exist for Algeria to finance capital imports by means of foreign loans and investments. Non-French investors have been harassed continually since conclusion of the Franco-Algerian petroleum accords in 1965. In particular, antagonism between the Algerian government and US companies has mounted since June 1967. Many of the projects to which the Boumediene government appears dedicated have been viewed as either unfeasible or uneconomic by many governments, both Western and Communist, and by international agencies, including the World Bank. Consequently, the bulk of the financing of these projects will have to come from Algeria's own foreign exchange earnings.

19. If all or even most planned industrial projects are implemented, prospective foreign exchange earnings will not be adequate. Government investment is scheduled to exceed \$600 million in 1968, with about two-thirds of this amount earmarked for industry and infrastructure. Annual investment could reach nearly \$1 billion by 1970. Of this amount, about \$600 million would be spent on government imports, leaving an inadequate \$400 million of expected export earnings for consumer goods and capital imports by the private oil sector. If present investment objectives were even 80 percent achieved, imports of capital goods would rise to almost \$500 million for the government sector alone, and export earnings would barely cover imports. Therefore, total or substantial fulfillment of the investment plan would probably result in a decline in foreign exchange reserves.

20. Complete or near-complete implementation of investment plans is highly unlikely. In the past, government investment expenditures rarely have exceeded 50 percent of planned levels. The causes of this poor performance -- especially the disorganized administration of the economy -- cannot be removed quickly. Enough money is available and, in most cases, so are the necessary foreign technicians. Neither money nor technical personnel have been used efficiently or are likely to be for some years to come.

21. If investment projects continue to be implemented at about 50 percent, Algeria probably

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will continue to accumulate foreign exchange reserves. The following tabulation shows estimated import requirements for investment goods during 1968-70 under three alternative assumptions and the resulting impact on Algeria's foreign exchange reserves:

	Fulfillment of Investment Plan (Million US \$)		
	<u>100</u> <u>Percent</u>	<u>80</u> <u>Percent</u>	<u>50</u> <u>Percent</u>
Import requirements for investment goods (government sector)	1,480	1,184	740
Change in foreign exchange reserves	-369	-73	371

22. One of the crucial assumptions underlying the projections of changes in Algeria's foreign exchange reserves is that imports of consumer goods will remain constant at the 1967 level. As a result of declining per capita incomes, import substitution, and increasingly stringent restrictions, consumer imports have fallen by more than \$100 million since 1965. If development plans are fully implemented, incomes will rise and stricter regulations or a more strenuous effort to expand the output of domestic consumer goods industries will be required to contain consumer demand for imports -- especially since population is growing at about 3 percent annually. Thus far, Boumediene has been willing to hazard the political risks involved in suppressing already depressed consumption levels. Further limitations on imports are unlikely to be necessary, however. If investment remains sluggish, current restrictions and import substitution efforts should assure, at the very worst, a very slow increase in demand for consumer imports.

Long-Term Prospects

23. A few years hence, Algeria may be able to support both the planned industrialization program

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and reserve accumulation. By 1971, prospects for supplementing petroleum revenues will be much brighter. Negotiations for the sale of natural gas to Italy, stalled for several years, have been resumed. Recently Canada has designated Algeria as the preferred supplier of liquefied gas to the Northern and Central Gas Corporation. Together these two markets are expected to absorb about 6 billion cubic meters of Algerian gas per year, yielding an additional \$80 million in foreign exchange. If these two customers are secured, Algeria will become eligible for a long-deferred loan from the IBRD to develop additional production, transportation, and liquefaction facilities. With prospective income thus enlarged, Algeria could finance a large part of its heavy industrial development without seriously impairing its balance-of-payments position.

24. Nevertheless, a massive investment program in Algeria is unlikely to yield many benefits. In many past endeavors, government procrastination and ineptitude have caused initial costs to mount well above original estimates. Subsequent inefficiency has resulted in high operating costs and continual losses. Even if many of the planned projects are completed, the government may find that it is incapable of running them efficiently, profits may be nonexistent, and amortization of the investments may prove to be difficult. In any event, investment in capital-intensive heavy industry will provide little employment and will increase few personal incomes. The Algerian people will gain little from the industrial program for many years.

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